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***Building a Comprehensive Partnership with China***



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## Summary

China's development since embracing economic reform under Deng Xiaoping twenty years ago has been remarkable. The country is undergoing a dramatic internal transformation from a centrally-planned economy, largely closed off to the world, towards an increasingly market-driven one engaged in global commerce. This has been accompanied by a significant evolution in China's civil society, even if the full respect for universal standards in the field of human rights remains incomplete.

In 1995, the European Union responded to the economic and political challenges posed by the changes in China by drawing up a comprehensive policy for the future development of the EU's relations with China. It adopted, in the spirit of the "new Asia strategy" endorsed by the Essen European Council, a *Communication on a long-term policy for China-Europe relations*<sup>1</sup> that has served the EU well, providing a useful roadmap for the future.

Most of the initiatives within the 1995 strategic document are already underway, while others have yet to mature. The analytical foundations of the 1995 Communication still hold true, and it therefore remains the platform on which the EU's policy towards China is built. However, several developments of such significance have occurred since 1995 that the EU should respond by upgrading and intensifying that policy further.

Firstly, the Chinese Government recently gave its strongest endorsement of market reform and global integration since reform was launched in 1978. The XVth Chinese Communist Party Congress in 1997 ushered in the post-Deng era by endorsing an ambitious economic and social reform agenda for the next five years. This can be seen as a clear signal of China's intention to consolidate, accelerate and complete the transition already underway.

Secondly, China has become at once more assertive and more responsible in its foreign policy, both regionally and globally. China's role in promoting peace in Korea and Cambodia reflects its renewed commitment to the development of Asia as a whole. An unprecedented series of summits between China and some of its key world partners over the last year have demonstrated China's wish to be recognised as a world power while reflecting a common perception among these partners that constructive engagement with China should become a key policy priority. The smooth and successful handover of Hong Kong to Chinese sovereignty in July 1997 was a particularly clear expression of China's increasingly mature and responsible approach to its changing role in the region and on the world stage.

Thirdly, the financial crisis that began to spread across Asia in 1997 has exposed serious structural weaknesses in the economies of some of China's neighbours and will inevitably have some impact on China itself. It could be seen as an early warning for China since it highlighted the risks associated with certain aspects of the

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<sup>1</sup> COM (95) 279 du 5.07.95.

development paths followed by other Asian countries. The crisis underlines the need for further reform and liberalisation within China to guard against similar problems arising in its own economy.

Finally, the EU itself is changing in ways that will lead China to adjust its own strategic vision of the European continent. The EU stands on the threshold of a single currency and enlargement eastwards, and with the Treaty of Amsterdam has equipped itself with new means to assert itself on the world stage.

Such developments call both for long-term vision and for active engagement. Engaging China's emerging economic and political power, as well as integrating China into the international community, may prove one of the most important external policy challenges facing Europe and other partners in the 21st century.

This Communication seeks to meet that challenge by building upon the analysis of China's political and economic development set out in the 1995 document in order to set the priorities for a new, comprehensive EU-China partnership.

The new EU-China partnership will aim at:

- **Engaging China further, through an upgraded political dialogue, in the international community**
- **Supporting China's transition to an open society based upon the rule of law and the respect for human rights**
- **Integrating China further in the world economy by bringing it more fully into the world trading system and by supporting the process of economic and social reform underway in the country**
- **Making Europe's funding go further**
- **Raising the EU's profile in China.**

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## **A. Engaging China further in the international community**

China's emergence as an increasingly confident world power is of immense historic significance, both to Europe and to the international community as a whole. China has become a major partner in a world increasingly bound together by the forces of globalisation. The EU's prime objectives must be to see China integrated rapidly and fully into the international community, both politically and economically, and to support its transition towards an open society based upon the rule of law: this will facilitate both development in China and greater global stability.

The EU is committed to a strategy of comprehensive engagement with China. This should be achieved through a renewed and upgraded EU-China bilateral political dialogue, as well as through the greater involvement of China in both regional and multilateral initiatives of global interest.

### ***A. 1 Upgrading the EU-China political dialogue***

China's willingness to play a greater role on the world stage has been demonstrated recently by an unprecedented series of bilateral summits with Japan, Russia and the US, giving each of these key partners the chance to display publicly their shared commitment to China.

Up until 1994, the EU's political dialogue with China was limited to short annual meetings in the margins of the United Nations General Assembly. The EU has steadily intensified this political dialogue, following an exchange of letters in 1994. The time has now come for the EU and China to raise the status of their relationship by holding annual summits at Head of State and Government level, encouraging contacts at ministerial level, and by holding meetings between Political Directors in a similar vein to contacts with other key partners. Annual EU-China Summits would put the EU-China relationship on a commensurate footing with the EU's approach towards other major international partners such as the US, Japan and Russia, raise the profile of the EU in China and vice versa, as well as injecting added momentum into the negotiation and resolution of key issues in the EU-China relationship.

### ***A. 2 Building upon the ASEM process***

The Asia-Europe Meetings (ASEM) process, launched in Bangkok in 1996, has developed into a broad forum for in-depth consultations between European and Asian partners at political and expert level, and has stimulated a wide series of cooperation initiatives. By virtue of its informal nature and the variety of issues addressed in its framework, ASEM has added a new dimension to the EU-China relationship. China

has taken a constructive approach in the process and has been particularly active in all ASEM economic cooperation initiatives.

Dialogue with China should be upgraded in the context of the EU's broader regional strategy towards Asia as embodied in ASEM. The EU should aim to encourage China's continued commitment to taking an active part in ASEM and the ASEM follow-up process. Promoting dialogue with China on sustainable development in the Asia region, addressing the issue of maritime security in the Asia region, combatting illegal drugs trafficking, coping with the effects of the Asian financial crisis and addressing the issue of arms control and non-proliferation are prime examples where the EU should seek China's active involvement in ASEM.

### ***A. 3 Addressing global issues***

Over recent years China has been forging a more coherent and outward-looking foreign policy to match its growing economic weight. The EU should build on this by encouraging China to play a proactive and responsible role in global issues.

The EU should engage China, a permanent member of the United Nations Security Council, in dialogue on major UN developments, in particular UN reform.

The EU should endeavour to raise issues related to China more regularly during G7/8 meetings. It should also work to intensify the increasingly substantial dialogue with China launched by the OECD in 1995.

China's status as a nuclear power gives particular importance to its disarmament and non-proliferation policy. In recent years, China has taken the welcome steps of joining the Nuclear Non-Proliferation Treaty, the Chemical Weapons Convention, the Biological Weapons Convention and the Zangger Committee (a nuclear export control regime), as well as respecting key provisions of the Missile Technology Control Regime. It also signed the Comprehensive Nuclear Test Ban Treaty. Continued support and encouragement should be given to Beijing's greater involvement in multilateral negotiations on such issues. Europe should also establish dialogue with China on the anti-personnel landmines issue, urging it to adopt a permanent export ban and to engage positively in the international process to eliminate these weapons.

Illegal immigration and international crime are issues of grave concern both to China and the EU. The EU should promote a substantial dialogue and encourage cooperation with China on combatting illegal drug trafficking, money-laundering, organised crime and illegal immigration. Previous EU experience in other third countries on such issues could constitute a useful platform on which to consider launching specific cooperation initiatives in China.

The EU will continue to take every opportunity, within the political dialogue, to raise human rights issues in addition to the specific bilateral dialogue on human rights detailed in section B of this communication.

The way China's economy develops, its energy demand increases, and the pace of rapid industrialisation continues, is having a profound environmental impact at the national, regional, and global level. The EU should aim to ensure China's continued commitment to addressing world environmental challenges such as global warming and greenhouse gas emissions, not least through EU funded cooperation projects mentioned in section C2. In particular, the EU should encourage China's further involvement in the pursuit of global environmental objectives in the context of the 1992 Rio Earth Summit and its follow up, notably in the area of climate change.

#### ***A. 4 Fostering dialogue on Asian regional issues***

The EU has a role to play in maintaining stability in the Asian region through the non-violent resolution of conflicts there, notably as a participant in ASEAN-sponsored regional fora. China shares its frontiers with fourteen countries and has unresolved border disputes with some of them. The growing demand for a multilateral security dialogue in East Asia provides opportunities for Europe to increase its overall influence in the region. As the ASEAN Regional Forum (ARF)<sup>1</sup> develops further, and as China shows willingness to engage further in confidence-building measures in Asia, the EU should use this forum more systematically to discuss security issues with China.

Europe, a key contributor to the Korean Peninsula Economic Development Organisation (KEDO) and a major provider of food aid to North Korea, has a clear interest in the peaceful resolution of the Korean question, as does China. The Korean peninsula should be among key issues that feature in the EU's regular dialogue with China.

Likewise, the EU and China could consider launching a dialogue on other countries in the region, such as Cambodia, Vietnam and Burma, where China has strong influence.

China's increasing reliance on energy imports from Central Asia is bound to make it perceive stability in the region as a strategic priority. Given the EU's own strategic interest in Central Asia and privileged relationship with Russia, developments in Central Asia should be addressed at the appropriate time and in the appropriate forum.

Recent indications of an improvement in relations across the Taiwan Straits and the prospect of a more open and direct dialogue between Beijing and Taipei are encouraging. As before, the EU should welcome any steps which can be taken to further the process of peaceful reconciliation.

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<sup>1</sup> The ASEAN Regional Forum (ARF) was established in 1994 as a forum bringing together intra and extra regional powers to examine issues of security in the Asia-Pacific region with a view to maintain peace and stability. It comprises the nine ASEAN member States, the ten ASEAN dialogue partners (Australia, Canada, China, South Korea, United States, India, Japan, New Zealand, Russia and the European Union) and the two ASEAN observers (Cambodia and Papua New Guinea).



### ***A.5 Underpinning autonomy in Hong Kong and Macau***

Strong economic links and historical ties with Hong Kong and Macau make it inevitable that Europe will continue to take an active interest in the two territories, not least in view of the latter's handover in 1999. In the spirit of its 1997 Communication entitled "*The European Union and Hong Kong: Beyond 1997*",<sup>1</sup> the EU should seek to underpin further the autonomous responsibilities of the Hong Kong Special Administrative Region, following the smooth handover in July 1997 and the successful management of the post-handover period so far. The Commission will publish an annual report on EU-Hong Kong relations. It will also aim to ensure that the EC-Macau Trade and Cooperation Agreement remains fully implemented after Macau's handover to support Macau's autonomous responsibilities. Hong Kong and Macau have important roles to play as gateways to other regions of China, and the EU should develop bilateral cooperation initiatives with both territories.

The EU considers the continued expression of differing opinions through the media and other channels in Hong Kong to be a healthy sign of political maturity. The EU will continue to watch the electoral process in Hong Kong closely, placing particular emphasis on the EU's support for the eventual development of universal suffrage in the SAR.

#### **Proposed initiatives:**

- **Propose annual EU-China Summits and other top-level meetings as well as EU-China Political Directors' meetings**
- **Enhance still further China's involvement in ASEM**
- **Cooperate on the future of the UN**
- **Raise awareness of China-related issues within G7, and encourage further dialogue between China and OECD**
- **Propose dialogue on non-proliferation and cooperate on reinforcing related export controls**
- **Urge China to integrate fully into the global arms control process, notably to introduce a permanent ban on the export of anti-personnel landmines**
- **Cooperate on combatting drug trafficking, money-laundering, crime and illegal immigration**
- **Raise the issue of human rights within the political dialogue**
- **Develop dialogue on environment and sustainable development**
- **Discuss Asian regional security with China**
- **Develop dialogue with China on Korean peninsula, Central and South-East Asia**
- **Work to underpin autonomy of Hong Kong**
- **Ensure a smooth transfer of sovereignty in Macau in 1999 and develop cooperation with Macau**

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<sup>1</sup> COM (97) 171 final, 23.04.1997.

## **B. Supporting China's transition to an open society based on the rule of law and the respect for human rights**

China is still far from meeting internationally accepted standards on human rights. Serious shortcomings in China's human rights record remain, including in such areas as the suppression of freedoms among certain ethnic minorities and political dissidents, use of enforced prison labour, a still under-developed system of rule of law, and the extensive use of the death penalty. These remain matters of grave concern to the EU, its Institutions and public opinion at large.

Nonetheless, the situation of human rights in China has improved over the last twenty years. Economic reform has introduced greater freedom of choice in education, employment, housing, travel and other areas of social activity. China has passed new civil and criminal laws to protect citizens' rights and has signed several key instruments bringing the country closer to international norms. It has also taken steps to develop the electoral process at local level, allowing villagers to designate their local authorities.

A commitment to universally recognised human rights and fundamental freedoms lies at the heart of the EU's policy worldwide. Full respect for these principles is inextricably linked to economic development and prosperity, as well as the long-term social and political stability of any country.

The challenge for China now is to sustain economic growth and preserve social stability while creating an open society based on the rule of law. If Europe wishes to have a role in this process, it should continue to use all available channels to promote the cause of human rights in China in an active, sustained and constructive way. The resumption of the EU-China human rights dialogue without any pre-conditions gives the EU a real opportunity to pursue intense discussions which, coupled with specific cooperation projects, remains at present the most appropriate means of contributing to human rights in China.

### ***B. 1 Promoting human rights through open debate...***

The EU believes in the merits of dialogue, in all appropriate fora, over confrontation. The EU and China should therefore tackle their differences in a frank, open and respectful manner.

An EU-China specific dialogue on human rights was launched in 1995 and interrupted in the Spring of 1996. Since its resumption in November 1997, China has shown a new-found willingness to engage in a serious and results-oriented dialogue. All subjects of concern, even the most sensitive ones, have been addressed during the discussions and the prospect of continued, regular dialogue has now been established. Furthermore, this dialogue has enabled the EU to obtain China's agreement in principle on a cooperation programme designed to strengthen the rule of law and

promote civil, political, economic and social rights. Since the dialogue resumed, China has given a series of encouraging signals, including its decision to sign the UN Covenant on Economic, Social and Cultural Rights. China has also given an undertaking to examine the UN Covenant on Civil and Political Rights with a view to signing it, and has increased dialogue with the UN authorities in the field of human rights.

The EU will continue to urge China to sign and ratify the UN Covenant on Civil and Political Rights, to ratify the UN Covenant on Economic, Social and Cultural Rights and to fully implement both covenants. Furthermore, the EU will encourage enhanced cooperation with specialised UN bodies and raise all issues of concern, including the plight of certain Chinese citizens.

As it attaches great importance to the respect for the cultural, linguistic and religious identity of ethnic minorities, the EU will continue to raise issues relating to these matters in Tibet within the bilateral dialogue on human rights.

Finally, the Commission will continue to press, within the International Labour Organisation, for the ratification by all members, including China, of the ILO conventions on core labour standards, including those on freedom of association, the right to collective bargaining, the prohibition of forced labour, of exploitative child labour and anti-discrimination.

## ***B. 2 ...and through cooperation***

The resumption of the EU-China dialogue on human rights has placed renewed emphasis on the constructive resolution of differences. This gives the European Union a chance to put its good intentions into practice and deliver tangible assistance. Two major priorities should be pursued:

- **Promoting the rule of law.** The EU should help China's efforts to develop a society based on the rule of law. Developing a sound and transparent legal framework, both in the civil and criminal sphere, providing rights to Chinese citizens - including the right to a fair trial - making them aware of those rights, and training lawyers and judges, would help achieve this goal as a first step. The EU is currently devising an ambitious programme of legal and judicial cooperation with these objectives in mind which will be discussed with Chinese authorities and ready for implementation by Autumn 1998.
- **Strengthening civil society.** The EU should aim to strengthen those practices which make up the fabric of a strong civil society. It should promote civil and political rights through initiatives such as the support for a training centre in China for officials engaged in the implementation of the village governance law. It could also allow for assistance to the most vulnerable groups in society, including ethnic minorities, women - as a follow up to the Beijing 1995 conference on Women - and children. Initiatives aimed at promoting consumers' rights and at supporting consumers' organisations could also be a way of strengthening civil society. The

role of Non-Governmental Organisations in implementing projects aimed at strengthening civil society should be fully exploited.

**Proposed initiatives:**

- **Urge China to sign, ratify and fully implement UN Covenants on human rights and ILO conventions on core labour standards**
- **Reinforce bilateral human rights dialogue with China**
- **Back up dialogue with concrete cooperation programmes**
- **Promote rule of law**
- **Strengthen civil society**

## **C. Integrating China further in the world economy**

The scale and speed of China's economic growth are making it one of Europe's major economic partners. China's trade with the world has almost doubled in value over the last five years, and it now runs a massive trade surplus both with Europe and with the United States. It has become the second largest recipient of foreign direct investment in the world after the United States, and the tenth largest trading nation. It is forecast by the World Bank to become one of the top three traders in the world by 2020.

China's unprecedented economic development has required a delicate balance between rapid economic growth, far-reaching reforms and the need to preserve social cohesion. This process has potential repercussions both for China and for the world economy, and it is in Europe's overwhelming interest that this transition be nurtured right through to its fruition, making China a strong, stable and open partner.

It is the EU's view that the objective of assisting China to become a global economic player fully integrated in the world economy and able to comply with common rules should be achieved through a combination of trade discussions and targeted cooperation initiatives. This strategic approach should seek to accelerate and consolidate China's integration into the world trading system while supporting the reforms that are so vital for China to thrive within that system.

### ***C.1 Bringing China into the world trading system***

EU-China trade has increased more than twenty-fold since the beginning of the reforms, making China the EU's third extra-European trading partner and creating vast potential for European trade and investment there. The EU's trade deficit with China reached 20 billion ECU in 1997, reflecting China's growing export capacity as well as the obstructive effect of market barriers in China itself. The EU should use all available channels, notably China's WTO accession process and the EU's bilateral

trade negotiations, to iron out such barriers and help create an open Chinese economy that benefits European and global interests alike. Improving the climate for European investment in China should also be one of the EU's top objectives.

### 1.1. Supporting China's accession to the WTO

The EU remains one of the keenest advocates of China's early accession to the WTO. It will provide an important boost for China's economic reform and will signal strengthened international confidence in the reform process. It will also cement China's place in the global economy and provide traders and investors with greater certainty when doing business in China. Furthermore, striking the right terms of accession for China will be a determining factor in the pace and scope of further multilateral trade Rounds.

Financial turbulence in Asia has triggered a crisis of confidence in several Asian economies which could have spillover effects in China. Against this background, China has a prime interest in demonstrating its continued commitment to the WTO accession process as a means of sustaining outside confidence in the fundamental health and dynamism of the economy. Closing markets or delaying reforms would be a misguided and counterproductive response to financial market instability.

China has made significant progress in recent years to liberalise its trade regime and open its economy to the world. Whether on tariff cuts, currency reform or the development of the legal system, the pace of change has been remarkable, and together, the EU and China are progressing towards a trade relationship which should culminate in China's membership of the WTO. However, for this goal to be achieved, sustained efforts still need to be made by China to respect the following commitments:

- Meet key WTO principles such as:

**transparency**, including prompt publication of all relevant laws and regulations, clear licensing criteria and better identification of the authorities responsible for granting licences.

**national treatment**, notably by offering the same operational conditions to foreign companies as to domestic ones.

**non-discrimination** against EU companies vis-à-vis those of other trading partners.

- Offer real market access for industrial and agricultural goods by cutting tariffs significantly - including the removal of tariff "peaks" (duties of 15% and higher) and adherence to the Information Technology Agreement - and by removing all quotas, unjustified technical barriers to trade and other non-tariff measures. This should be achieved as a follow-up to the conceptual breakthrough negotiated by the European Commission with China in October 1997, in which a series of precise principles were agreed which provide clear parameters in which the negotiations on China's detailed tariff commitments are being pursued.

- Rapidly remove the current monopolies on foreign trade so that all Chinese or foreign nationals in China can engage in import and export.
- Provide substantial opening of China's services market in distribution, telecoms, financial services, professional services, tourism, travel and medical services. China is today moving into a new phase of economic development in which services will be the engine of future growth. Foreign companies would bring vast assets to China in terms of jobs, technology, on-the-job training and management skills.
- Open the financial sector (banking, securities and insurance) in a more systematic and comprehensive, if gradual, manner. This would boost China's long-term growth and outside confidence in the economy, and can be pursued without prompting uncontrollable capital movements and excessive volatility. It is also in China's interest to set up a proper regulatory framework and independent supervisory authority.
- Improve the conditions for foreign companies establishing in China. This includes removing all restrictions on the legal form of establishment (whether as a joint venture or a wholly-owned company), lifting geographic restrictions and those on the scope of permitted activity, and removing pre-establishment conditions. It also includes the removal of export performance requirements and export subsidies.
- Eliminate WTO-incompatible measures designed to promote priority industries.
- Rapid implementation of the WTO TRIPS Agreement and full enforcement and protection of intellectual property rights.
- Establish a transparent, open and competitive procurement regime. A key objective in this regard would be to secure China's membership of the WTO Agreement on Government Procurement as part of the WTO accession package. China has the largest procurement market in the world and failure to obtain access to that market would significantly reduce the overall value of the market access package.
- Join the WTO-related Civil Aircraft Code.

The EU's approach during the accession negotiations should continue to be characterised by the following features:

Firstly, the EU must negotiate resolutely to secure firm and viable market opening commitments commensurate with China's stage of development, potential and size, in order to make China's accession a lasting success.

Secondly, the EU has developed the concept that part of the final package may require the use of clearly defined transition periods for sectors where China needs to phase in its WTO obligations beyond the date of accession while adjusting its laws and

practices. This approach has been put forward by the EU to respect China's own policy of implementing reforms gradually.

Thirdly, the EU should encourage China to anticipate accession by setting as an early priority the amendment of domestic laws and regulations that affect foreign investment, the aim being to make its investment regime less restrictive, more unified and its evolution more predictable.

Finally, the EU should be on hand to assist China as it makes the necessary adjustments, whether through cooperation or by offering practical assistance during the negotiations themselves. The EU is already drawing up a series of cooperation programmes designed to support China's reforms during and beyond the accession process, especially while it is adapting to WTO disciplines during transition periods. This initiative will include programmes to raise awareness of WTO principles - such as on intellectual property, public procurement, norms and standards, and customs - among Chinese officials at all levels of government and business executives, as well as aligning China's legislative and regulatory framework with WTO rules. WTO will also be a central theme in a broader training programme for the Chinese administration. Furthermore, the EU will develop a specific post-accession dialogue with China to ensure the implementation of its WTO commitments both during the phasing-in period and beyond.

The EU is ready to conclude the negotiations as soon as China shows it can offer genuine market opening, if necessary phased in gradually according to an agreed timetable, and ensure that the country becomes an open, proactive and forward-looking WTO member ready to participate in further liberalisation. Above all, China's WTO accession should not be seen as a new constraint imposed by the outside world on China, but rather as a supportive process which will strengthen its own internal reform programme.

## **1.2. Strengthening the bilateral trade agenda**

The EU has a long history of trade relations with China, as embodied within the 1985 EC-China Trade and Cooperation Agreement<sup>1</sup> and the EC-China Joint Committee meetings. Bilateral trade discussions should be pursued alongside the WTO process as an effective means of exchanging information and resolving bilateral issues. They provide a useful forum for ensuring strict adherence to the principle of non-discrimination, for example in fields such as maritime transport and financial services. Issues pursued within this bilateral dialogue should dovetail with the EU's Market Access Strategy, launched in 1996 to target the removal of obstacles to EU exports and investments worldwide. In parallel, the EU should use this bilateral channel to gain information concerning the implementation of China's WTO commitments and to ensure that these commitments are given concrete effect.

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<sup>1</sup> OJEC L 250/1, 19.09.1985.

China is, by far, the main beneficiary of the EU's Generalised Scheme of tariff Preferences (GSP), with more than 30% of the value of all beneficiaries' imports in 1997. However, the implementation of the scheme's graduation mechanism (in which GSP advantages for certain sectors are withdrawn due to the high level of industrial development in those sectors) will necessarily reduce the advantages previously enjoyed by China. Nevertheless, the new GSP special incentive arrangements (social and environmental clauses)<sup>1</sup>, will allow beneficiary countries to obtain an additional preferential margin, provided they meet international standards of labour rights (International Labour Organisation standards on child labour, freedom of association and rights of bargaining) and environmental protection (International Timber Organisation standards on sustainable management of tropical forests). In the event of applications from China, the Commission will examine carefully if China meets the requested standards.

The European Commission has proposed amendments to the EC anti-dumping legislation vis-à-vis China that take account of the market reforms underway in the country. The proposal<sup>2</sup> includes the removal of the label "non-market economy" which applies to China under the current legislation, by instituting a new case-by-case approach in anti-dumping proceedings whereby Chinese exporters, who are found to operate within clearly defined market economy conditions, will be granted market economy treatment. This means that the domestic prices and costs of such exporters will be used to establish normal value rather than information from a market analogue third country.

The proposal also introduces a more systematic approach to the granting of individual treatment and calculation of comparative advantage. The proposal will reflect the specific behaviour and operating conditions of individual firms, whilst at the same time acting as an incentive for further reforms among Chinese companies. As such, it will interact positively with the ongoing WTO accession negotiations.

The EU has confirmed to China that it is ready to phase out its quantitative restrictions on Chinese products as rapidly as China is able to remove its own. The removal of both sets of quantitative restrictions should be pursued as part of an overall market opening strategy and in the context of the WTO accession negotiations.

The Commission and Member States need to be fully updated at all stages on commercial legislation and administrative practice governing trade in goods and services in China. A strengthening of coordination and the regular exchange of detailed information between the Member States' Embassies and the Commission's Delegation in Beijing would make for a more efficient and focused bilateral trade dialogue.

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<sup>1</sup> COM (97) 534 final, 29.10.1997.

<sup>2</sup> SEC (97) 2290.



### 1.3 Promoting investment

The development of Foreign Direct Investment (FDI) has been a key element of China's economic growth since it engaged in reforms in 1978. For several years, China has been the largest recipient of FDI among developing countries, and has now become the second largest recipient of FDI, after the United States. Investments originating in the Asia-Pacific region, notably from Hong Kong and Taiwan, dominate FDI in China, thus highlighting the regional dimension of China's integration into the world economy. The Asian financial crisis, which will reduce incoming FDI in China, makes it all the more important for China to further attract investment from its other partners, especially Europe and the United States.

The EU should aim at improving the investment environment for European companies in China. The construction of a sound and transparent regulatory framework for investment and a better enforcement of Chinese regulations on intellectual property rights are prime examples to achieve this objective.

The EU trade policy must be backed up by a comprehensive strategy to promote investment, as well as business and industrial cooperation with China, so as to strengthen the European presence in the Chinese market. The EU should launch such a strategy, focusing primarily on those industrial sectors - such as telecommunications, energy, environmental technology and services, transport and financial services - where Europe has a clear competitive advantage (*see also section C.2*). The EU should strengthen the EU's export and investment promotion facilities for China, in particular the *European Community Investment Partners* (ECIP) programme, which aims at supporting the creation of joint-ventures between European and Chinese companies in China, and the *Asia-Invest* programme, which aims at helping European small and medium-sized enterprises identify potential partners in China. The EU should continue to devote particular attention to small and medium-sized enterprises in its business and investment promotion strategy in China.

### 1.4 Developing bilateral agreements

The EU-China trade dialogue could be further strengthened through the conclusion of specific bilateral agreements in areas of particular interest, such as:

- **Maritime transport.** A sectoral agreement on maritime transport, for which the Commission has a negotiating mandate, should aim to strengthen cooperation with China and improve market access conditions for European operators in China. The EU intends to base this agreement on the principles of freedom to provide maritime services, free access to cargo activities and unrestricted access to ancillary services. The agreement may provide for the establishment of a Working Party which could report to the Joint Committee set up under the EC-China Trade and Economic Cooperation Agreement.
- **Air transport.** The conclusion of a Memorandum of Understanding between the Commission, China and the European Association of Aeronautical Industry on

Industrial Cooperation in the Aeronautical Sector could be a starting point for cooperation in the field of air safety, environment and infrastructure. This cooperation should be accompanied by the commencement of a dialogue in aviation matters.

- **Nuclear trade and safety.** The Commission should study the merits of negotiating a bilateral agreement with China in areas related to nuclear trade and nuclear safety in the framework of the Euratom Treaty. China's policy on nuclear non-proliferation is a key issue that should be taken into account in such an analysis.
- **Customs.** The Commission has been authorised to negotiate an agreement on customs cooperation and mutual administrative assistance. This will serve the dual purpose of facilitating trade between the EU and China on the one hand, and creating a framework through which to fight customs-related fraud on the other.
- **Science and technology.** A specific EU-China science and technology agreement should be concluded in order to enhance and expand cooperation in fields such as energy, environment, life sciences, material sciences, transport, telematics, information and communication technologies. It will strengthen the presence of European economic operators in China.

### **1.5 Making financial liberalisation and regulation go hand in hand**

The creation of a sound financial environment is vital to sustain the confidence of investors and traders in China. The financial crisis that has struck some of China's neighbours in 1997 can be seen as an early warning signal from which China can learn. It throws into sharp relief the need for China to build a solid, transparent and open financial and banking system, and to make bank lending market-driven and commercially viable in order to avoid exposure to weaknesses similar to those of other Asian economies in future.

Together with the reform of its State-owned enterprises, China has embarked on an ambitious reform of its financial system. This includes the creation of a sound regulatory framework for financial activities. The EU fully supports this and is ready to offer China, through cooperation projects, its own expertise in financial regulation and prudential supervision. This should also be pursued through any initiative which could be taken within ASEM.

At the same time, the EU should seek to persuade China that liberalisation of its financial services markets - notably market access for foreign financial service providers in banking, insurance and securities - would strengthen the wider banking reforms. It would increase liquidity, prompt a more viable and effective allocation of credit within the economy, raise standards and increase available expertise, boosting jobs and growth in the process. An early commitment to include financial services within China's WTO offer would increase investor confidence at a time when it is severely lacking in some of China's neighbours. This would not entail any sudden

exposure to market risk, as the EU has not suggested that China should introduce full freedom of capital movement in the near future.

## **1.6 Promoting the euro**

The advent of Economic and Monetary Union makes it important for the EU to inform China of the major changes EMU will bring to its economic ties with Europe, as well as to the international monetary system itself. In parallel with its commitment to the construction of a sound and open financial and banking system in China, the EU should establish a regular EU-China macro-economic dialogue. This dialogue should aim, *inter alia*, at informing China - which already has the world's second largest foreign currency reserves - about EMU and about the potential of the euro as a stable reserve currency.

Within the information actions on the euro aimed at third countries which the European Commission will develop, special attention should be given to China.

### **Proposed initiatives:**

- Give continued impetus to WTO accession negotiations until a viable accession package is achieved
- Allow China to benefit from transition periods while certain sectors adapt to WTO obligations
- Offer China cooperation projects to help its economy adapt to WTO obligations
- Re-activate bilateral trade talks to exchange information and resolve issues of mutual concern
- Use bilateral trade talks to cement commitments made in the WTO process and improve synergy of these talks with the EU's market access strategy
- Adopt the Commission's proposed new anti-dumping regulation towards China and Russia
- Pursue gradual and reciprocal removal of EU and Chinese quantitative restrictions
- Develop a comprehensive EU investment promotion strategy and business and industrial cooperation in China
- Develop bilateral agreements in specific sectors
- Urge China to liberalise financial services in step with reform of its financial system and provide relevant EU expertise
- Inform China about the importance of the Euro as a stable reserve currency

## ***C.2. Supporting economic and social reform***

China's reforms are radically changing the economic and social landscape of the country. The pace of reform is impressive, but the process remains fragile and incomplete. The challenge for China is to pursue its economic transition whilst at the same time integrating the concept of sustainability into economic growth and guarding itself against social instability. The EU should therefore not just seek to negotiate the removal of trade and investment obstacles, but also help China build the institutions, policies, human resources, management techniques and other flanking instruments that constitute the fabric of a modern, outward-looking economy.

The resources available for this process will always be small in comparison with the needs. If the EU is to maximise the impact of these resources, cooperation needs to be concentrated on a small number of key objectives.

The five traditional pillars of EU-China cooperation set out in the 1995 Communication - human resources development, administrative and social reforms, business and industrial cooperation, environmental cooperation, rural and urban poverty alleviation - have stood the test of time through the successful implementation of a range of projects, and the principles behind the 1995 long-term strategy will continue to underpin the EU's approach to its cooperation programme. This approach was further developed in the EC-China Memorandum of Understanding on the programming of EC-China cooperation projects signed in Beijing in October 1997 between the Commission and the Chinese Authorities.

Given the pace of change in China, it is important to further update the objectives of the EU-China cooperation programme in keeping with the reforms taking place in China. The following specific priorities - to which must be added WTO-related cooperation projects (section C.1.1) and human rights cooperation projects (section B) - should be highlighted:

1. **Side-effects of company restructuring.** China is restructuring many of the State-Owned Enterprises (SOEs) which still form the core of its industry. This process of unprecedented scale and complexity could have major social and political side-effects. The EU should not try to address all aspects of a reform process of this magnitude, but rather focus on limited priorities, in close coordination with other donors, notably the World Bank. From its experience with restructuring and privatisation, both within the EU and in Central and Eastern Europe and the New Independent States, the EU would be well placed to offer its expertise as China introduces new models of ownership, corporate governance, accounting and management. The EU could also help China address welfare reform, which is one major fall-out of SOE restructuring since the Chinese welfare system in urban centres is largely taken care of by SOEs themselves. In keeping with China's desire to minimise the social side-effects of economic reform, and in order to contribute to urban poverty alleviation, the EU could help China in its search for new models of welfare, including medical care, social security, unemployment insurance and pensions.

2. **Financial reform.** China has wisely embarked on the reform of its financial system, whose fate is closely linked to that of the debt-ridden state-owned enterprises. A sound, transparent and market-driven banking system is indispensable for the creation of a sustainable economy. The EU - in close cooperation with both international and Member States' financial institutions responsible for financial supervision and prudential standards - should help China to develop the kind of rules, supervisory mechanisms and prudential standards that will enable it to guard against structural weaknesses exposed elsewhere during the Asian financial crisis.
3. **Industrial cooperation.** Sectoral cooperation schemes focusing on those sectors where EU industry has clear competitive and technological advantages and China has specific needs should be developed as a way of tackling issues such as regulation, the definition of common norms and standards, the development of mutually recognised certification procedures, the integration of cleaner production processes, as well as industrial and commercial training. Administrations, regulatory bodies, and industries from both sides should be involved in this exercise. Small and medium-sized enterprises should be encouraged to participate in this process. Priorities for forthcoming initiatives could include telecommunications, information technologies and aeronautics.
4. **Business dialogue.** The EU should support a greater involvement of European business and industry in China. A business dialogue should bring together EU executives and Chinese businessmen and policy-makers in order to increase awareness of China's transition process and provide expertise on market reform. The results of this dialogue should also be used to identify further priorities for EU trade policy and cooperation initiatives.
5. **Legal and administrative reform.** The EU should back up its bilateral and multilateral trade negotiations with concrete assistance to China in reforming and modernizing the overall legal and administrative framework of its economy. Definition and enforcement of legislation - for example in intellectual property, company law and public procurement - as well as administrative organisation and management should be among the specific targets. The EU's continued support to the construction of a sound and competitive procurement regime would, in particular, increase industrial competitiveness and help China establish a modern and efficient public sector.
6. **Training.** Cooperation should help China strengthen its own training capacities by proposing modern professional training standards and practices. This should address the needs of both administration and industry. Vocational training programmes for industry would both help up-grade the quality of manpower in China and promote European management practices, technical know-how and standards, thus facilitating European investment. Likewise, training initiatives for public servants would help them face the challenges of a market-driven economy open to the world.

7. **Science and technology.** Scientific and technological cooperation should be used more actively as a means to strengthen European companies' position on the Chinese market as well as supporting China's own economic development. It should focus on agriculture, information and communication technologies, biotechnology, material sciences, transport, energy, the environment and natural resources. A specific EC-China Science and Technology Agreement should be negotiated rapidly (*see Section C.I.4*), and a web of partnerships should be created to allow the exchange of young scientists, managers and engineers in selected economic sectors.
8. **Environment.** China has become increasingly aware of the environmental cost of its former industrial model, and of its impact on the global environment. It is now seeking to reconcile rapid growth with sustainable production and consumption patterns. The EU should, along the lines set out in the *Communication on a Europe-Asia Cooperation Strategy in the Field of Environment*<sup>1</sup> develop cooperation projects focusing on clean production methods, waste minimisation, environmental standards and training, and environmental management capacities as well as appropriate technology transfer. The EU should in particular help China integrate environmental priorities - such as the prevention of industrial pollution and greenhouse gas emissions, and the conservation of biological diversity - further into national economic policy-making processes and into development schemes at regional and local levels. Where desirable, and in line with the Chinese objective of reducing poverty, environmental conservation and poverty alleviation projects should be integrated together.
9. **Energy.** Europe should offer its environmental and energy know-how to China to help it develop efficient and clean industries and also to establish a presence in its potentially lucrative market for green technology, along the lines set out in the Commission's *Communication on a Europe-Asia Cooperation Strategy for Energy*<sup>2</sup> Promoting energy efficiency, as well as developing clean coal technologies and alternative energy resources, notably natural gas, should be top priorities. The EU should seek to develop synergies with international financing institutions (IFIs) on these issues.
10. **Regional disparities, poverty alleviation and social cohesion.** Despite a significant rise in living standards, China is still a developing country. Rural and urban poverty are rife, China's vast floating population presents a serious threat to social stability and lasting economic prosperity, and disparities between advanced coastal regions and less developed inner provinces have become a key concern for both Chinese local and central authorities. The EU should help China accelerate the spread of prosperity across the country and improve regional and social cohesion through, inter alia, projects aimed at developing all communication links between coastal and less developed inland regions. This could in particular increase the attractiveness of inner regions for both Chinese and foreign investment.

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<sup>1</sup> COM (97) 490 final, 13.10.1997

<sup>2</sup> COM (97) 308 final, 18.07.1996

#### **Proposed initiatives:**

- **Provide expertise to reduce side-effects of company restructuring, notably welfare reform**
- **Provide expertise for financial sector reform**
- **Strengthen industrial and business cooperation**
- **Cooperate on legal and administrative framework**
- **Develop human resources cooperation with focus on professional training and exchange schemes**
- **Expand scientific and technological cooperation**
- **Promote sustainable development and help China integrate environmental policy concerns**
- **Foster transfer of know-how and technology in energy sector**
- **Develop cooperation to reduce regional disparities, alleviate poverty and improve social cohesion**

### **D. Making Europe's funding go further**

A comprehensive policy for relations with China needs to be backed up with the appropriate financial means to implement it. The EU's budgetary resources for China have more than tripled as a direct result of the policy launched in 1995, rising to around 70 million ECU per year up to 1999, from an annual average of 20 million ECU over the 1991-1994 period. This has enabled the EU to demonstrate its commitment to cooperation with China by pushing forward with the vast majority of new ideas proposed. As such, the current envelope appears sufficient at this stage to finance both the shorter and longer-term initiatives outlined in this Communication, so long as the budget is maintained for the 2000 to 2006 period.

Nevertheless, the EU should consider all possible avenues for improving the efficiency of its activities.

One key message of this Communication is that EU-funded cooperation programmes need to be even more closely linked with the EU's broader China policies. From the human rights dialogue through the WTO accession negotiations to questions relating to China's economic development, the EU should seize the chance to underscore its policies with concrete assistance projects where at all possible. The EU is emerging as one of the most important grant donors in China, and every effort should be deployed to maximise this advantage. Giving projects direct relevance to key policy objectives is one of the best ways of improving their efficiency. It is a simple exercise in value for money which could be achieved without increasing the overall budget allocated for China.

Like other international donors, the EU is continually looking for ways to improve the delivery of projects. So far, it has tended to concentrate on relatively high-budget programmes spread over several years. This maximises the impact of a cooperation budget which will remain small in relation to the needs of a country the size of China. Nevertheless, there are five important refinements that should be introduced:

Firstly, the EU faces an ever-increasing demand for supporting small but highly visible projects. Some of these initiatives - such as making European expertise available rapidly for the development of new legislation, professional training, networking with EU counterparts, organisation of seminars, and the production of information and communication material etc - have a potential impact going way beyond the small budget involved. The European Union should develop a facility whereby a selection of the very best of these smaller projects could be funded directly and rapidly from the Commission's Delegation in Beijing.

Secondly, synergy between the EU and Member States' cooperation programmes is still underdeveloped. Mechanisms for improving coordination, complementarity and possible joint projects should urgently be considered.

Thirdly, in view of the limits imposed by a relatively modest cooperation budget, the Commission has been exploring ways of collaborating more closely with international financing institutions. New opportunities have opened up for using EU grant-funded projects to prepare the way for larger funding from organisations such as the World Bank. In addition, the EU should envisage funding European experts in some of the Bank's policy related discussions with the Chinese government. This benefits all partners concerned and is particularly well suited to sectors like welfare reform, energy and the environment.

Fourthly, the European Investment Bank (EIB), which has a mandate for intervention in Asia up to the year 2000, has currently a modest degree of involvement in China. Up to now, it has launched one project - in the field of energy - with a budget of 50 Mccus. It appears, however, that there is room to improve the EIB's involvement in China within the existing mandate. This is even more important in the context of the World Bank's intention to scale down its development assistance through concessional financing and to abolish all concessional financing from 1999 onwards. The issue of the size and allocation of the EIB's financial envelope in Asia after the expiry of its present mandate remains open.

In order to ease the EIB's entry into China, make its lending more competitive and strengthen its implementing capacity, the Commission is ready to consider apportioning part of its cooperation budget to the EIB in order to fund feasibility studies and pre-investment analysis which would prepare the ground for EIB loans for projects of common interest implemented by institutional borrowers in China. An improved intervention of the EIB in China would increase the visibility of its cooperation work in China and raise the profile of its relations with the country more generally.



Fifthly, it is essential to continue close dialogue with the Chinese authorities in order to ensure that project development responds to shared objectives. This dialogue should encompass all phases of the project cycle, with particular attention put to the programming phase, as illustrated by the Memorandum of Understanding on programming of 1998 and 1999 cooperation signed in October 1997 between the Commission and the Chinese Authorities.

As a result of this dialogue, an early discussion and exchange of information with Member States on the basis of multiannual programming would also contribute to increased synergies with Member States programmes. The same applies for the EIB, World Bank and other donors.

**Proposed initiatives:**

- **Facilitate rapid funding of small, short-term projects out of Beijing**
- **Increase synergy between EU's China policy objectives and cooperation programmes**
- **Improve synergy with EU member states**
- **Investigate different means and approaches for collaboration with World Bank and other lenders**
- **Cooperate with EIB to expand EIB activities in China within existing mandate**
- **Strengthen regular dialogue with China on programming and project cycle, and ensure early information of Member States and IFIs**

## **E. Raising the profile of the European Union**

The reemergence of China is having a profound effect on public opinion. Few businesses, institutions or individual people outside China are not aware in some way of its rapidly growing profile on the world stage. For some it is perceived as an inexhaustible source of opportunities, others are more cautious in their assessment; most see it as a broadly positive development that requires a carefully balanced but decisive response from their public authorities, including the European Union. For such a response to be effective, it must be visible, not just in Europe, but in China and the world at large. Greater visibility will give the EU added weight in its dealings with China.

Close coordination within the EU itself will be needed if the EU is to raise its profile in China successfully. Annual summits and other high-level meetings with the Chinese leadership, of the kind recommended in section A.1 of this Communication, would go some way to improving visibility, and should be given adequate exposure to the media.

The EU should also upgrade its information policy towards China substantially. As a first step it should draw up its first-ever information strategy devoted solely to EU relations with China. The strategy should identify key target audiences within business, government, academia, NGOs, the media and other groups in order to diffuse information about the relationship. Such audiences should, where possible, be

sought in China as well as in Europe. A new information strategy could include the following actions, among others:

**Proposed initiatives:**

- **Set up a Commission Press and Information Service (SPI) in Beijing, to add to those already existing in Washington and Tokyo**
- **Expand the number of Chinese visitors travelling to Europe i.e. through the EU Visitors' Programme**
- **Increase the intensity of cultural exchange through schools, universities and other educational establishments**
- **Organise cultural initiatives such as exhibitions and explore means to develop future cooperation in the cultural field**
- **Increase the presence of the EU at conferences devoted to Chinese affairs and organise seminars and conferences on the subject of EU-China relations**
- **Expand cooperation with existing EU Studies Centres in Chinese universities and with the Chinese Society for EU Studies**

## **Conclusion**

China's growing political and economic self-confidence should serve as an incentive for the EU to engage the country more fully. Its growing strength has been matched, by and large, by a growing sense of responsibility. China's increasing assertiveness on the world stage therefore deserves a positive response from Europe. It also requires vision. This Communication seeks to set out that vision by laying the ground for a comprehensive partnership based on a set of specific, action-oriented initiatives.

The focal point of that vision must be to ensure the successful and lasting integration of China as an equal partner in the world economy. This should be coupled with an active commitment to creating a strong and open civil society based on fundamental freedoms and human rights, in step with China's move towards a market economy. China's WTO accession process, as well as the EU's bilateral trade agenda with China, remain key instruments, together with Europe's elaborate cooperation programme with China, to bring this to fruition. At the same time, the EU must be ready at short notice to adapt its policy to any unforeseen changes prompted by the speed and scope of China's transition.

Europe and China both stand on the threshold of critical change. This should give the former the added incentive to craft its own genuinely European strategy towards the latter.

The Council is invited to endorse the initiatives laid out in this Communication, and to invite the Commission, the European Parliament, Member States, business and other actors to cooperate in pursuing the approach outlined. The Commission stands ready to move forward with the initiatives outlined in the months ahead.

The Commission will regularly report to the Council and the European Parliament about the progress made in the implementation of the proposals of this Communication. A yearly report will be produced to this end.

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